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The significance of the large phenomenon: how ostensive responds to social structures

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Short Abstract

The role of context in the development of organizational routines is under-theorized. Specifically, it is unclear how ostensive aspects of routines relate to the broader social structures and how such relationships affect their formation, development, and internal dynamics. In this paper, we draw on an in-depth historical case study of the global financial Crash of 2007-2008 as a field-wide crisis which was partly driven by the malfunctioning evaluation routine of rating agencies, and examine how the ostensive dimension of the routine evolved in the run up to the crisis. We discuss the role of two discourses which subsequently led into paradoxical inconsistencies in the routine functionality: market discourse and professionalism discourse. The findings show that, in the immediate years preceding the financial crisis, a market discourse increasingly dominated the finance market as there was unprecedented demand level for financial products. As a result, the rating agencies were facing high volume rating of the packages, while, at the same time, struggled to retain their staff. Hence, the routine was robbed from its resources in the finance sector (e.g., by investment banks); a vicious cycle that eventually reshaped the ostensive routine and undermined its functionality. The professionalism discourse, as the official stance of the rating agencies in their conduct of the routine throughout, however, was weakened in the run up to the crisis, but regained its strengths afterwards as rating agencies started to reposition the routine as robust and objective.

Keywords: Evaluation Routines, Ostensive, Financial Crisis, Sub-Primes, Field, Discourse

Introduction

The global Financial crash of 2007-2008 was a field-wide crisis partly driven by the malfunctioning evaluation routine of rating agencies. A field-wide crisis consists of “perceptions by field actors (e.g. organizations, regulators, investors, customers, etc.) that fundamental outcomes are in contrast to expectations, and precipitate action intended to avoid dramatic negative outcomes” (Sine and David, 2003: 186). In the aftermath of the financial crisis, a number of explanations were provided as what caused the financial crash and what factors contributed to it. Among the reasons provided, the malfunctioning of the rating agencies in evaluation of non-prime Asset Backed Securities (ABS) and Collateralized Debt Obligations (CDOs) were regarded as the main contributing factors. In the same vein, it has been widely argued that the evaluation routine failed to meet its primary purpose, which was

to accurately rate the financial products that had become widely traded within the sector over the years in the run up to the financial crisis (FCIC 2011).

Given the significance of the role that credit evaluation played in the crisis, there has been considerable controversies around the routine and how it has been enacted. Therefore, there is a need to understand how the routine developed in the way it did towards the financial crisis. However, understanding the role and development of evaluation routine without attending to the broader social structures would be misleading. The finance sector has many actors with a very complex network of relations and interactions which contribute to the development of the routine.

Extant routine literature is rather unclear as how routines relate to the broader social structures and how such relationships affect their formation and development (Safavi and Omidvar 2016). In particular, two observations about the state of routine research are worth mentioning. First, there is a tension on whether the large phenomenon is important, or even relevant. Stability, change, inertia, and flexibility of routine have been extensively discussed (Turner and Rindova 2012, Dittrich et al. 2016, LeBaron et al. 2016). However, despite the useful insights that this research provides, the change/stability or flexibility/inertia tensions are treated rather locally. Inertia, and stability have more to do with the ongoing state of routine within their local settings rather than a struggle between the local settings and social structures, and the large phenomenon (Nicolini 2016) is often taken for granted; that is, stability is assumed to be pursued by social structures.

Second, notwithstanding the anchoring of ostensive aspect of routines in structures, it is not clear how the two relate. Despite Feldman and Pentland's (2003) discussion of how ostensives guide routines and their being mainly aligned towards structures, the discussion of such relationship is not further explored in the following literature. They note that ostensive is led by structures and pertains to the collectively held understanding of the routine and its patterns by routine participants. Nevertheless, the structures are mainly treated locally and in the form of managerially prescribed conduct of routines. Even in the latter sense, we believe that the relationship between the ostensive aspect and managerial intentions are not fully explored (c.f. Feldman 2015 for a discussion of underexplored relationship between strategy and routines).

Attending to these aspects, we explore how the ostensive dimension of the routine evolved in the run up to the crisis and we particularly attend to the dynamics between the finance field and the routine. We discuss the role of two discourses in the development of the ostensive aspect of routine which subsequently led into paradoxical inconsistencies in the routine functionality: market discourse and professionalism discourse. The findings show that, in the immediate years preceding the financial crisis, a market discourse increasingly dominated the finance market as there was unprecedented demand level for financial products. This meant that there was such a demand by the market that made the rating agencies process a much greater number of financial products within a shorter time span and compromise their hitherto-held rigor in analysis of the products. Due to the increased level of demand for ratings, rating agencies were facing high volume rating of the packages, while, at the same time, they struggled to retain their staff. Due to the high salary levels of investment bankers, the turnover of staff in rating agencies was high. In other words, the routine was robbed from its resources by the field although its output enabled accumulation of resources elsewhere. This meant that the more ratings that the rating agencies processed, the more resources became accessible to the other actors within the field which, in turn, disproportionately disadvantaged the rating routine in terms of

its resources; a vicious cycle that would eventually undermine the functionality of the routine. The professionalism discourse was, however, the official stance of the rating agencies in their conduct of the routine throughout. However, it was weakened in the run up to the crisis, but regained its strengths afterwards as rating agencies started to reposition the routine as robust and objective.

The discursive anchoring of ostensive

While the performative aspects of routines refer to the specific performances in specific times of action; that is the practical knowledge of conducting a routine in an 'unrepresented state', the ostensive aspect, relates to routine in abstract, representing how routines are subjectively interpreted and understood by routine participants (Feldman and Pentland 2003, Dionysiou and Tsoukas 2013). It is tempting to assume that ostensives only represent a cumulative abstraction of the performances over time. However, the patterns of action may as well emerge as people engage with a 'broader range of patterns' not necessarily rooted in the very performance of the task but shaped and reshaped by networks of meanings and structures through which actors view and understand routines. Although these representations never precisely reflect the lived experience, they bear a relationship with them as actors thrive in ascribing order to the sequence of activities in routine. By providing a way of connecting the actual performances to abstract structures, the ostensive aspect serves as a midrange concept bridging the micro-level performances to the large-scale phenomenon (Feldman 2015).

The ostensive can convey the relationship between the routine and the macro through discourse. Discourse may appear either as part of routines (performances) or as their representations (ostensive aspects). In the former, like any other social phenomenon, routines have discursive as well as non-discursive elements (practices). In this regard, the discursive elements constitute the performative aspect of routines during each iteration. For example, Dittrich et al. (2016) explore the role of reflective talks in the change and stability of a pharmaceutical company's shipping routine. Their ethnographic findings explain how talk enables routine participants to collectively reflect on the routine and devise new ways of adapting specific performances when necessary.

The second way through which discourse relates to routines, which happens to be the interest of our paper, and which relates to the bridging the micro and the macro, concerns with the representations of the ostensive aspects of routines. In the same research and by the same findings, Dittrich et al. (2016) demonstrate how reflective talks enable the routine participants to collectively introduce changes to the routine's pattern by explicitly articulating "the patterns of past and current routine performances" and by elaborating on "different aspects of the pattern from their different perspectives" (p.688). This enables the routine participants to envisage variations in the routine patterns and evaluate them without having to enact them and provide a potential alternative for future performances.

Unlike performances which can be only realized in the very context within which they are being enacted, ostensives are open to interpretation as they 'travel' across actors, departments, hierarchical levels, and even organizations. For individual routine participants, they may have differences in their ostensive based on their functional roles (Zbaracki and Bergen 2010) or their socio-material contexts (D'Adderio 2014). An ostensive held by the routine participants, for example, may be considerably different from the ostensive held by the managers, and even routine participants may have different ostensives depending on their respective contextual settings. For example, the importance of transferring best practices not only within individual organizations but also across them is widely

discussed in the literature. In a sense, the idea of transferring best practices mainly concerns with transferring the ostensives because, as we know from the literature, the situatedness of practices means that they cannot be transferred but there is always an element of travel and transformation as they adapt to their context (Gherardi and Nicolini 2000). As such, one can assume that the discussion of transferring best practices concerns with the transfer of the 'ostensive aspect' of best practices. Although best practices/routines will eventually be locally adapted, their ostensive is exposed to interpretations that are external to their immediate context and not held only by their very participants.

As ostensives diverge from harmonically defined and understood patterns, they are constantly recontextualized. Such recontextualization, in turn, creates opportunity for compliance and resistance on part of the routine participants. In traveling across time and space, ostensives are molded by the discourses that they encounter. It is therefore, through the relationship between the ostensive and the discourse that routines legitimate certain practices while resist others. Zbaracki and Bergen (2010), although not directly referring to discourse, discuss the role and contribution of language and the way it is being used by routine participants in negotiating the routine changes. Exploring the effect of the art field on the admissions routine of an art college undergoing a merger with a university, Safavi and Omidvar (2016) demonstrate how the dominant features of the art field legitimized and, hence, enabled resistance to a prescribed change. In other studies, authors have analyzed the role of alternative discourses as means of resistance in the tensions between middle and top managers as well as their role in legitimizing or resisting change. What remains critical in all these studies is the manipulation of collective meaning during these processes (Hardy and Thomas 2014).

Methods

The research project will adopt an in-depth historical case study approach (Skocpol, 1984) which are particularly useful in understanding the causalities and the trace of events leading into the emergence of a key historical event, or phenomenon (Skocpol, 1984; Van de Ven & Sminia, 2012). The data collection will follow the classical separation between primary and secondary data in historical data analysis. Court testimonies, internal emails and reports about financial crisis will be the main types of archival data that will be used. In addition, around 30 interviews with various number of rating agency members in the aftermath of the financial crisis will be examined. Critical discourse analysis (Fairclough 2013) will be used to identify how the broader ostensive dimension of the routine was shaped and diffused in the industry.

Findings

The pressure for increased efficiency and profitability

The finance market heavily relies on the rating agencies to evaluate and rate the financial products in the sector. The US finance market is dominated by three rating agencies: Moody's, Poor & Standard, and Finches. When buying a structured finance, in addition to their own evaluation of the securities, investors rely on the judgement passed on to them by credit rating agencies. The higher the rating

grade the higher the perceived quality of the securities and the less risk involved in purchasing them. However, these ratings are not legally binding and they are predominantly considered as advisory despite the immense impact that they will have on the issuer and investor of the securities.

Rating agencies, therefore, are one of the cornerstones of the finance market which had built their reputation during the past century as the accurate and reliable sources of risk evaluation. They have been historically known for their rigor and their academic approach in 'getting the ratings right' by recruiting the best qualified statisticians and mathematicians in the market with PhDs from top US universities.

Since 2001, however, there was a number of changes in the operations of the rating agencies. First, there was a significant surge in the number and the total value of the securities that were rated. In response to the market demand, the rating agencies increasingly became aggressive in their competition for gaining market share. There was a significant growth in the value of the rating companies and their share prices increased more than 300% over a short period. Not only there was significant pressure to increase the market share and process a greater number of deals in the market, there was pressure for having more AAA ratings. The regulations in many of the states requires banks to hold assets with AAA rating or graded assets which are considered to be safe for a bank to hold as assets. Therefore, there was pressure for rating agencies to give higher ratings to make the securities attractive for the buyers.

The change in the approach and the culture of the rating agencies, resulted in changes such as increased involvement of investors in the rating process as they were now seen as the 'clients' whose interest should be served by reeducating the rating analysts to a new culture of cooperation with the investment bankers and increasing the confidence of the investment bankers to exercise power in their interactions with the rating agencies. The increased desire for growth and the need for processing a significant number of transactions required more resources. However, the rating routine was almost always under-resourced. This was associated with two other aspects. First, the best analysts were always attracted by the investment banks as they offered significantly higher salary leaving the routine depleted from the resources it required. Second, the routine's being under-resourced meant that the analysts did not have enough time to analyze the deals with the level of due diligence that they ideally would. They had more ratings to do in a shorter period of time which was aligned with the market interest in processing under-researched ratings.

The volatility of ostensive and ambiguity around the routine

One of the main reasons behind the substantial growth in the finance market was the introduction of structured securities (CDOs and RMBS) as innovative products which could yield high returns without imposing significant risks. However, these products brought with them complexity, and absence of a preceding history based on which a robust model could be developed. As a result, the models that were developed by the rating agencies lacked the historic data upon which they could be robustly built. This lack of clarity and robustness of the models, which were in great need of updating, resulted in a more flexible interpretation and application of the rating procedure (artefact allowing the manipulation aligned with the market interest). Therefore, aligning the routine with the interests of the market, the rating agencies had the leeway to include/exclude criteria from the model.

An analyst complaining about a rating decision in May 2005, wrote: "Chui told me that while the three of us voted "no", in writing, that there were 4 other 'yes' votes. ... [T]his is a great example of how the criteria process is NOT supposed to work. Being out-voted is one thing (and a good thing, in my view), but being out-voted by mystery voters with no 'logic trail' to refer to is another Again, this is exactly the kind of backroom decision-making that leads to inconsistent criteria, confused analysts, and pissed-off clients." (Email script, rating analyst)

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